taxnews

Tax News

February 2011

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2010 Filing Season Opens

We are now accepting 2010 state tax returns. Also, please note the following updates on law changes and filing services:

Standard deduction – The standard deduction for single or filing separately tax statuses increased from $3,637 to $3,670. For joint, surviving spouse, or head of household filers, it increased from $7,274 to $7,340.

Personal exemption credit – The personal exemption amount for single, filing separately, and head of household filers increased from $98 to $99. For joint or surviving spouses, it increased from $196 to $198. The dependent exemption credit is also $99 per dependent.

New Jobs tax credit still available – Starting in 2009, this incentive provides a tax credit of up to $3,000 for each added qualified full-time employee hired by a qualified small business employer. Funding is limited to $400 million. As of January 1, 2011, $360 million remains available. The credit must be claimed on a timely-filed original 2010 return received before the $400 million limit is exhausted.

Generally speaking, employers qualify for the credit if they employed 20 or fewer employees in the prior year. They must have a net increase in qualified full-time employees in 2010 compared to the number of full-time employees employed in the prior year.

Net operating losses suspended – For 2010 and 2011, net operating losses from prior years cannot be deducted by certain taxpayers. The net operating loss suspension rules do not apply to taxpayers with modified adjusted gross income (PITL) or preapportioned income (CTL) of less than $300,000 or with disaster loss carryovers.

Voluntary Contribution Funds – Taxpayers can contribute to one or more charitable causes directly on the state tax form. New on the 2010 tax return are the:

- Arts Council Fund.
- California Police Activities League (CALPAL) Fund.
- California Veterans Homes Fund.
- Safely Surrendered Baby Fund.

Access Your Account –This new service allows taxpayers to change their address or phone number and get information such as estimated tax payments, any balances due, state W-2 information, or FTB-issued 1099 forms online. Taxpayers and tax professionals complete a one-time registration where they choose their own user name and password. This service eliminates the need for taxpayers to get a customer service number each year.

MyFTB Account for Businesses - Coming in mid February 2011, business entities and their authorized tax representatives can view their prepaid estimated income tax payments online with MyFTB Account for Businesses. We encourage you to access My FTB Account for Businesses to verify estimated tax payments before filing, since claiming the wrong amount of estimated tax payments is a top processing error and errors delay refunds and result in tax bills after filing. Using this service you can also verify the exact entity name to use when filing the return, another common error causing processing delays. Go to ftb.ca.gov after February 14 and search for **MyFTB Account**.

Check Your Refund Status –After filing the 2010 tax return**,** taxpayers can use this service to see where their refund is. This service is also available in Spanish. In general, refunds for e-filed returns with direct deposit are generally issued within seven days and mailed refund checks are generally sent within two weeks. Refunds for paper-filed returns take longer, up to six to eight weeks depending on the time of year the return is filed.

Pay Taxes Online – Our Web Pay service allows taxpayers to authorize a payment from their bank account to pay their return balance due or extension payment. Payment must be made by April 18, to avoid penalties and interest. Taxpayers can also make estimated tax or any bill payments online, and sign up for email reminders of upcoming estimate payment due dates. Taxpayers can schedule payments up to one year in advance. For a fee, taxpayers can also pay their taxes online with their American Express, Discover/NOVUS, MasterCard, and Visa cards.

Request a Monthly Payment Plan – We offer monthly installment payment plans to those who cannot pay what they owe by the due date. Taxpayers who owe less than $25,000 and can repay the tax within five years generally qualify. Sign up online at ftb.ca.gov and select installment agreement request.

Federal Earned Income Tax Credit – This is a federal incentive for low-income individuals and families. Taxpayers earning less than $48,362 can qualify for a “refundable” credit up to $5,666. “Refundable” means that you do not have to have a tax liability to get a refund check from the federal government. If you think you might qualify, go to **irs.gov** and search for EITC **Assistant***.* California has no comparable state credit.

Recordkeeping – Keep a copy of your client’s state tax returns and all supporting records. We may request information regarding your client’s tax return at any time within the California statute of limitations period, which is generally four years from the return's due date.

IRS 2010 Filing Delay

Taxpayers who file their 2010 tax returns early have been advised by the IRS to wait until mid February 2011.The delay is due to Congress' late passage of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. The delay affects both paper and electronic filers.

Taxpayers affected by the filing delay are those claiming:

- Itemized deductions on Schedule A. The election to deduct state and local general sales and use taxes instead of state and local income taxes was extended for 2010 and 2011.

- The above-the-line deduction for higher education tuition and fees. This deduction of up to $4,000 of tuition and fees paid to a post-secondary institution is claimed on Form 8917, Tuition and Fees Deduction*,* to arrive at adjusted gross income (AGI). The IRS indicated no delays for taxpayers claiming education credits, including the American Opportunity Tax Credit, and the Lifetime Learning Credit.

- The above-the-line deduction for kindergarten through grade 12 educators with out-of-pocket classroom expenses of up to $250.

The IRS urges taxpayers to use e-file instead of paper tax forms to minimize confusion over the recent tax law changes and ensure accurate tax returns.

We are now accepting California income tax returns on paper or e-file. Taxpayers are not required to wait until they file their federal return, or prove they have filed. However, taxpayers will need to be able to prepare their federal return in order to properly prepare a California return. Filing a California return before the federal return may require the California return to be amended based on a final federal filing.

Some commercial software products may prevent the state return to be filed before the federal; if this occurs, taxpayers must contact the software provider for assistance.

The IRS will announce a specific date in the near future when it can start processing tax returns impacted by the recent law change.

Taxpayers can go to irs.ustreas.gov, or contact the IRS at 800.829.1040, Monday through Friday, 7 a.m. to 10 p.m.

FTB Checks Taxpayer Qualifications for Exemption of COD Income on Potential "Nonqualified Properties"

In January 2011, we began mailing letters to pre-selected individuals who received a Form 1099-C, Cancellation of Debt (COD), for tax years 2007 and 2008.

On April 12, 2010, SB 401, the Conformity Act of 2010 was enacted. The law largely brings California into conformity with the federal Mortgage Forgiveness Debt Relief Act of 2007 for discharges that occur in tax years 2007 through 2012. It allows taxpayers to exclude from their income the amount of qualified mortgage debt on their home loan that has been forgiven by their lender resulting from a foreclosure, "short sale," or loan modification. However, for California purposes, the amount of qualified mortgage debt is less than the federal amount, and a state-only limitation is imposed on the total amount of relief that may be excluded from gross income. Debt forgiveness on other types of properties, such as a second home, rental, investment, or business property ("nonqualified properties"), does not qualify for exclusion under the new law.

In an effort to measure compliance with the law, our review letters focus on COD income related to the "nonqualified properties." We advise such taxpayers that they may still be able to exclude COD income under other provisions and encourage all who receive the review letter to promptly respond. Failure to respond could result in formal audit action, penalties, and/or a tax assessment.

We provide the following information resources to assist taxpayers who received a 1099-C and/or who have questions regarding COD issues:

- ftb.ca.gov - Search for mortgage debt relief.
- IRS.gov - Search for home foreclosure and debt cancellation.
- IRS publication 4681, Canceled Debts, Foreclosures, Repossessions, and Abandonments
- Federal law – Mortgage Forgiveness Debt Relief Act and Debt Cancellation
- SB 1055 – Legislative Change 08-7
- Press Release April 2010 – California Enacts Mortgage Forgiveness Debt Relief
- Tax News February 2010 – California Code of Civil Procedures and Foreclosure
- Tax News November 2009 – Documents, Second Mortgages, Tax Reporting – How to Handle a Foreclosed Home for Tax Purposes
- Tax News July 2009 – Foreclosure and Short Sales

Roth IRA Conversion Frequently Asked Questions

California conforms to several recent federal law changes in the area of traditional and Roth IRAs. Each of these changes became effective January 1, 2010. One significant change now allows taxpayers using the married filing separate filing status to convert from a traditional IRA to a Roth IRA. Additionally, the limitation prohibiting Roth conversion to those reporting a modified adjusted gross income of $100,000 or more has been eliminated.

Lastly, a number of issues have arisen as a result of the change allowing taxpayers to make a Roth IRA conversion in 2010 and defer the recognition of income to 2011 and 2012. Below are answers to some of the most frequently asked questions.

Does California conform to this change?

Yes, California pre-conforms to many of the deferred compensation provisions of the Internal Revenue Code under Revenue and Taxation Code (R&TC) section 17501. Consequently, the change in federal law allowing taxpayers to report the taxable portion of their 2010 Roth IRA rollover ratably during 2011 and 2012 is applicable for California purposes.

Must a taxpayer make a separate California election or do conversions have to be treated the same for California purposes as for federal?

Under IRC section 408A(d)(3)(A)(iii), a taxpayer must elect out of deferring the income to 2011 and 2012. Any election for federal purposes will apply for California purposes. But, if a taxpayer elects out of the deferral for federal purposes, California will allow a separate election to not opt out of the deferral for California purposes and vice versa.

If a nonresident taxpayer who was not subject to California taxes in 2010 makes the election for federal purposes and moves into California during 2011 or 2012, is he or she bound by this election for California purposes?

Yes, under R&TC section 17024.5(e)(3)(B)(i), if a taxpayer made a valid federal election prior to becoming a California taxpayer, that taxpayer is deemed to have made the same election for California purposes unless a separate election is expressly authorized by statute. The R&TC does not provide for a separate election for purposes of Roth IRA conversions in these circumstances.

If a taxpayer chooses to defer to 2011 and 2012 and the taxpayer leaves California in one of those years how is the conversion treated for California purposes? Similarly, how is the conversion treated if a nonresident moves into California?

In Legal Ruling 98-3, Taxation of IRA Distributions Rolled Over to a Roth IRA Followed by a Change of Residence Status, we provided guidance as to the tax treatment of California residents who converted a traditional IRA to Roth IRA in 1998 and then change residence during the ratable period between 1999 and 2001, as well as the tax treatment of non California residents who converted an IRA to Roth IRA in 1998 and then become California residents in the period between 1999 and 2001. The analysis in this ruling remains applicable to the new deferral rule allowing taxpayers to report the income from the conversion of a traditional IRA ratably over the two years following the conversion.

Outbound taxpayers must include in gross income only those portions of the taxable distribution reportable under the two year rule before they became nonresidents. Under R&TC section 17952.5 the gross income of a nonresident does not include qualified retirement income including income from an IRA, received on or after January 1, 1996. R&TC 17952.5 prevents the imposition of California tax on the portions of the IRA distribution recognized after an individual becomes a nonresident.

California will allow for the proration of the taxpayer's income from the conversion based upon the number of days a taxpayer is within California during the two years of the proration. An individual who makes a rollover contribution from an IRA to a Roth IRA before January 1, 2011 and changes residency in 2011, must include in California adjusted gross income one half of the taxable portion of the distribution multiplied by a fraction, the denominator of which is the total number of days in the taxable year and the numerator of which is the number of days in the year in which the individual is a California resident.

If the taxpayer changes residency during the second year, the amount included in California adjusted gross income for the year of the change in residency is one half of the taxable distribution multiplied by a fraction, the denominator of which is the total number of days in the taxable year and the numerator of which is the number of days in the year in which the individual is a California resident.

Real Estate Withholding Rates Decrease

As of January 1, 2011, the California real estate withholding rates changed. The optional gain on sale withholding rates decreased for individuals and non-California partnerships to 9.3 percent, S corporations to 10.8 percent, and financial S corporations to 12.8 percent.

Assembly Bill ABX3 3 (Evans, Stat. 2009, Ex. Sess. 20009/2010, Ch. 18) applicable to taxable years beginning on or after January 1, 2009, and before January 1, 2011, resulted in an increase to the optional gain on sale withholding tax rate for individuals, non-California partnerships, S corporations, and financial S corporations. This tax rate increase does not apply to taxable years beginning on or after January 1, 2011.

For updated forms which include the reduced tax rates, go to ftb.ca.gov and search for **withholding requirements**.

Interest Rates Decrease

The adjusted interest rate has been determined for the period July 1, 2011, through December 31, 2011.[1] The interest rate will decrease from four to three percent. This rate is compounded daily and accrues with respect to various state taxes including: personal income, corporate income, and franchise. The rate for corporation tax overpayments for the period will remain zero percent.

To find adjusted interest rates, both current and past, go to ftb.ca.gov and search for **interest rates**.

[1]Pursuant to Section 19521 of the Revenue and Taxation Code

Over $15 Million in Returned Tax Refunds Checks

We are holding more than $15 million in returned state income tax refunds.

This year nearly 49,000 refunds, ranging from $1 to $218,000 were returned to the state by the US Postal Service.

Typically, refunds are returned because the taxpayer changed residences after filing a tax return. Encourage your clients to update their address by using **MyFTB Account** at ftb.ca.gov . We reissue returned refunds automatically once we receive a new address.

Your clients who are expecting a state refund, or are unsure if they received their refund, who can access **Check Your Refund Status** on our website. This service is available in both English and Spanish.

Encourage your clients to use direct deposit when filing their tax returns. Direct deposit is a fast and secure method to receive your tax refund within days rather than waiting weeks for a refund check in the mail. Plus, direct deposit eliminates returned refund checks due to inaccurate addresses. This year, more than 4.6 million California taxpayers used direct deposit to receive nearly $4 billion directly into their bank accounts.

Free Power of Attorney (POA) Webinar

Do you know when to use a POA? Would you like hear why we send back your POA form and how to avoid common errors? Join us for a free webinar and get the information you need.

Participants attending this webinar will receive an overview of the following topics:

- What is a POA?
- When a POA is required
- When a POA is not required
- Alternative Forms
- Avoiding Common Errors

Date/Time: Thursday, February 17, 2011 at 10 a.m. (PST)

Duration: This webinar is approximately 30 minutes.

Register here

For more information, go to ftb.ca.gov and search for **POA webinars**.

Available Now: Free California Source Income Withholding Webinar in February 2011

We will host a free California source income withholding webinar in February 2011. The topic is:

Property Management Withholding
We designed this webinar for property managers who must withhold on California source income payments to nonresident property owners. We will look at:

- The basics of nonresident withholding.
- Backup withholding.
- A summary of the three phases of withholding and what to do before payment (Forms 588, 589, 590), at the time of payment, and after payment of California source income to nonresident property owners (Forms 592, 592-V, 592-B).
- How we are preparing for process changes that will occur when we implement our new, automated withholding system.
- Withholding resources and contact information you can use at any time.

Date/Time: Thursday, February 24, 2011, 10 a.m. (PST)

Duration: This webinar is approximately 30 minutes.

Register here

Registration only takes a few minutes. Space is limited.

The Patient Protection and Affordable Care Act and Impact on California Tax

On January 24, we sent a Tax News Alert with the following information:

The Patient Protection and Affordable Care Act signed by the President in March of 2010, requires benefit plans that provide coverage for family members to cover adult children of the employee, to age 26 whether or not they qualify as dependents for tax purposes, effective for plan renewals beginning on or after September 23, 2010. The Health Care and Education Reconciliation Act of 2010 extends the general exclusion for reimbursements for medical care expenses under an employer-provided accident or health plan to any child of an employee who has not attained age 27 as of the end of the taxable year. This law also amended federal income tax laws to exclude the value of an eligible adult child's medical coverage from the taxable income of the parent-employee. Federal law also allows self-employed individuals a deduction for health insurance premiums for an adult child under age 27 who is not a dependent.

California law has not been amended to conform to the 2010 federal income tax rules which exclude the value of the medical coverage provided to nondependent adult children from California gross income and allow a deduction to self-employed individuals for health insurance premiums for nondependent adult children under age 27. For California income tax purposes, the fair market value of employer-provided medical coverage for some adult children in excess of the amount paid by the employee for such coverage may result in taxable income to the employee. Any amount paid by an employee for such additional coverage is excluded from federal, but not California taxable wages.

- The additional income is reportable and taxable to the employee, not to the adult child.

- The amount of income included in taxable wage is equal to the amount by which fair market value of the taxable benefit received by an employee exceeds the amount the employee pays for the benefit.

In addition, self-employed individuals may not deduct the health insurance premium paid for an adult child under age 27 who is not a dependent.

For more information, go to www.edd.ca.gov/Payroll_Taxes/

Small Business

Online Filing Available for Tax-Exempt Organizations

Starting January 1, 2011, a new California law requires tax-exempt organizations, other than churches and church-related organizations, with average gross receipts of $25,000 or less to e-file with us or risk losing their tax-exempts status.

We are mailing notices to the more than 256,000 tax-exempt organizations meeting the criteria to file using FTB 199-N, also known as the e-postcard. Available online, the e-postcard asks the same basic information as the IRS Form 990-N. The due date is the same for state and federal purposes — by the 15th day of the 5th month **after** an organization's tax year ends. For example, organizations whose calendar year ends December 31, 2010, must file by May 15, 2011.

A tax-exempt organization that fails to file the e-postcard for three consecutive years loses its tax-exempt status and may be liable for the $800 minimum franchise tax. Any organization losing its status will have to reapply for tax exemption.

For more information, go to ftb.ca.gov and search for **exempt organizations**, or call us at **916. 845.4171**.

Ask the Advocate

NASSCO-Corporate Minimum Tax

The Board of Equalization recently ruled in the Appeal of NASSCO Holdings, Inc 2010-SBE-001, November 17, 2010, that a corporate taxpayer may use Enterprise Zone credits and/or the Manufacturing Investment Credit (MIC) to reduce corporate alternative minimum tax (AMT). Since then, I have received many questions on how the FTB is going to implement this ruling. We will be revising Form 100 Schedule P in February 2011. In addition, the NASSCO decision applies only to corporate taxpayers, and does not apply to personal income taxpayers, due in part to differences in how the corporate and personal income tax statutes are drafted. Consequently, personal income taxpayers may not claim the credits at issue in NASSCO in the manner that a corporation could.

The most frequent questions I have heard on this issue are “Can I file an amended return?” and “How will this affect my credit carryover?” Unfortunately, we have yet to determine answers to these questions. Stay tuned however as we are working to get the answers to these questions and more as soon as possible. We will update you in a future Tax News article and possibly a Tax News Flash as information becomes available. In addition, you can go to ftb.ca.gov and search for **nassco** for additional information.

Steve Sims, EA
Taxpayers’ Rights Advocate

Follow me on Twitter at twitter.com/FTBAdvocate.

Event Calendar

As part of education and outreach to our tax professional community, we participate in many different presentations and fairs. We provided this calendar to show the events we are attending.

Education and Outreach			
February Events			
Date	Event Association	Subject Matter	Location
10	Auburn Small Business Class	Classes for small business development	Auburn
16	Board of Equalization	Small business fair	Carlsbad
18	East Bay Association of Enrolled Agents	Ca Tax Question Panel	Dublin
17	Board of Equalization	Small business fair	Westminster
March Events			
10	Economic Development Corporation of Shasta County	Enterprise Zone Policy Meeting	Redding
22	UC San Francisco	Tax workshop(s)	San Francisco
April Events			
No events scheduled for April			

Inside FTB

Tax News Conducts Survey

Over the next week, Tax News plans to email a survey randomly to the Tax News subscribers via email. If you receive the survey, please take a few minutes to complete it. We welcome your feedback and appreciate your honesty. With your help, we hope to build a better product for you.

Criminal Corner

Bakersfield Couple Arrested for State Income Tax Fraud

A Bakersfield couple was arrested on eight felony counts including tax fraud.

Agustin E. Ramirez, 56, was charged with four felony counts of conspiring to commit a crime, grand theft, filing fraudulent returns, and money laundering. Maria Z. Ramirez, 54, was charged with four felony counts of conspiring to commit a crime, grand theft, filing fraudulent returns, and being an accessory to a crime.

The couple allegedly failed to report more than $380,000 in kickback income from the purchase of Bakersfield homes on their 2006 and 2007 state income tax returns. The couple owes the state more than $57,000 in unpaid taxes. Penalties, interest, and the cost of investigation will be added to this amount.

We initiated the investigation when they received information from the Kern County District Attorney’s Office, which alleged that Agustin E. Ramirez participated in a scheme to purchase five homes in the Bakersfield area between November 2006 and January 2007 by using fraudulent loan applications.

Officers from the Bakersfield Police Department arrested Agustin E. Ramirez on November 19, 2010, and Maria Z. Ramirez was arrested on December 8, 2010. Their bail is set at $2 million and $1 million respectively.

Big Business

Large Corporate Understatement Penalty (LCUP) Stands

On December 13, 2010, the California Court of Appeal rejected claims that Revenue and Taxation Code (R&TC) Section 19138, a corporate tax penalty provision for understating taxes by more than $1 million, is a tax and not a penalty (California Taxpayers' Association v. Franchise Tax Board, Court of Appeal of California, Third District, No. C062791, December 13, 2010). In finding California's large corporate understatement penalty to be just that - a penalty - it is not subject to the two-thirds legislative vote requirement, and therefore is valid. They also concluded that the post-payment refund action provided under the statute afforded taxpayers paying the penalty adequate due process protections.

R&TC 19138 was added by SB X1 28 and became effective December 19, 2008. This statute created a new penalty that applies to corporations for taxable years beginning on or after January 1, 2003, where the corporation has an understatement of tax in excess of $1 million. The penalty is 20 percent of the understatement, which is measured by the difference between the correct amount of tax and the tax reported on the original return or on an amended return filed on or before the extended due date.

For taxable years 2003-2007, a taxpayer could have filed an amended return and paid the tax shown on the amended return by May 31, 2009, to treat the tax shown on this amended return as tax shown on the original return. This one-time increase of self-assessed tax was allowed for corporations to reduce the likelihood of receiving this penalty for these taxable years.

LCUP Current Statistics -

Amended for More:

- 169 taxpayers filed 448 tax years (2003 to 2007) and *reported* $2,613,313,829 on their amended for more returns.
- From our records, it was determined that $2,602,436,448 of the amended for more amount was paid via electronic funds transfer payments and $64,715,030 was transferred from other tax years. This resulted in a total of $2,667,151,518 being applied, by the taxpayers, for the amended for more returns.
- The payment amount is greater than the reported amount because some taxpayers included interest.

Claims for Refund:

- Of the 169 taxpayers that filed amended for more returns, 38 of them have filed claims against 90 years. The total amount of claims filed to date is $475,858,277.

Penalties Assessed:

- FTB has assessed a total of 10 LCUP penalties for $3,800,000.